The Canadian Chartered Accountant

OFFICIAL ORGAN OF

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

Published monthly; subscription $3.00 per annum in advance; single copies thirty-five cents. Advertising rates sent on request.

The Editorial Committee will be pleased to receive contributions on subjects of interest. Papers which may not be deemed suitable will be returned, if desired.

Publication Office,
10 Adelaide Street East, Toronto
W. A. McKAGUE, Editor.

VOLUME XLIV — FEBRUARY 1944 — ISSUE No. 247

(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

Editorial Comment

The National Overhead

Every accountant and auditor has witnessed on one or more occasions the destructive influence of uncontrolled overhead—the burden of expenses incurred for the general good of an enterprise but without adequate regard for their productive value. It is therefore the duty of the accountant or auditor, without being prejudiced one way or another in the matter of politics, to be conscious of the same hazard in public life, and to see that other citizens also are aware of it. In this particular period, when so many causes are seeking public support, there is a grave danger of our accumulating an undue national overhead. A state project may be worthy and yet unwarranted.

There is altogether too much evidence that present day government is influenced more by pressure than by public opinion. Any wise administration keeps its ear to the ground so as not to run foul of the great mass of voiceless voters—but it makes the positive concessions to those groups which crowd it the most. The effect of years of agitation for health insurance is taking shape in a program which looks like several hundreds of millions of dollars per year. It follows old age pensions, mothers' allowances,

pensions for the blind, relief, and unemployment insurance. There is a current accumulation of liability in respect to people in the services, on a much higher scale than in the last war, and plans are being made for rehabilitation. There is a drive to convert housing, which in the past stood on its own feet, into a subsidized state enterprise. Transportation ambitions, which have cost many countries so dearly in the matter of railways, ocean leviathans and motor roads, are now expanded to include the airways. One could add together enough promotions to absorb the entire national income. That would put us all on public works, and leave no one on the farms.

A government has to balance its budget, however, and can never do so by merely recovering a part of what it spends. Of course it can get by for a time through some borrowing, but that inflates the price level and, by thus robbing the savings of the past, destroys confidence in saving for the future. One of the first things a government has to do, in framing its post-war plans, is compute the tax modifications deemed necessary to restore civilian activity, and that means a contraction in public spending. It can not meet the situation by assuming new obligations as fast as the war outlay is curtailed. For this reason Canada, like all other nations, has to choose carefully, and very carefully, among the vast number of schemes which are put forward for our general welfare, and at our general expense.

Still a Competitive World

Whatever we may choose to do internally, the world in which we live remains competitive. We may restrict and restrain, distribute and redistribute, yet when we put on the world market whatever surpluses we may have, then competition is met. Canada has a wide variety of resources and industries, but it is far removed from self-sufficiency. Russia and the United States are the only two countries which are nearly sufficient unto themselves, but let us leave their own respective problems where they belong. We Canadians can not produce cotton, nor silk, nor coal in the right places, nor cheap rubber, nor a thousand other things which enter into ordinary living. Therefore, we have to sell in order to buy, and when we do offer to sell, there is always a competitor at our elbow. Consequently we have to produce just as efficiently, and offer to

sell just as cheaply, as does the other fellow. We can not hope to corner all the natural resources—that is debarred by the Atlantic Charter. Nor need we expect that the allied nations are going to build a wall around our markets. That breeds wars. For these reasons, as well as for our own good, we cannot afford too much national overhead. Most of us have to be employed in producing things which we can consume or sell, and if we are not permitted to do this job efficiently, then none of us can secure, by the process of international trade, those things that are needed to round out our consumption.

The Dominion Tax Payment Schedule

Readers of The Canadian Chartered Accountant have indicated considerable appreciation of the "Dominion Tax Payment Schedule" which was included as a supplement to our January issue and, up to the time this is written at least, no serious fault has been found with our effort to set forth in tabular form the essential yet complicated requirements of the income tax and its accessories. While various journals from time to time have indicated in a similar style the more immediate income tax duties, this is, as far as we are aware, the most comprehensive schedule of its kind. Incidentally, the Income Tax Division itself is rather lax in such presentations. It volunteers assistance to everybody — but for the citizen to take a half day off, or to send his wife instead, and to wait in line at busy counters only to be redirected elsewhere, is a vexatious means of getting rid of money. The predicament of the large numbers of people who are distant from an income tax office is still worse. It is therefore hoped that the published schedule will be of help and, if so, that it may be revised and republished from time to time.

Reserves and Provisions

In this issue we print a recommendation of The Institute of Chartered Accountants in England and Wales on the subject of Reserves and Provisions followed by comment from "The Accountant". The recommendation attempts to clarify a subject on which there is, as "The Accountant" states, a bewildering variety of practice, and on which the text-books themselves are ambiguous or con-

tradictory. It urges that the terms "provisions" and "reserves" should no longer be regarded as interchangeable; the former should be confined to amounts set aside for specific requirements, and the latter should apply to reserves which are free. The full text is printed in this issue because the subject is one of equal interest in the Canadian field, and some useful conclusion might be reached by careful study of the step which has been taken in England.

Consolidated Returns Under The E.P. Tax

The Department of National Revenue has issued a new regulation regarding consolidated returns under The Excess Profits Tax Act, which though dated November 11th, first appeared in The Canada Gazette of December 25th, just too late for the January number of THE CANADIAN CHARTERED ACCOUNTANT; it is included in the present issue. The notice points out that, since The Excess Profits Tax Act is silent on the matter of the standard profits of parent and subsidiary companies filing consolidated returns, it falls within the Minister's power of regulation. The new regulation in effect limits the standard profits of a group of companies to the amount allowed for the operating company which has the highest standard plus $5,000 for each other subsidiary. For example, if there were four subsidiaries with $125,000 standard each, making an aggregate of $500,000, the new standard would be $140,000. While there were abuses, no law or regulation can ever succeed in plugging all loopholes; the new regulation tends to punish many innocent parties in order that no guilty one shall escape. Moreover, the regulation applies only to companies "that elect or have elected since 1st January 1940 to file consolidated returns" which creates an invidious distinction without regard for right or wrong. Through the power of regulation it converts a law, which was intended to appropriate all profits in excess of an accepted standard, into a law which appropriates all profits over and above a level which is purely arbitrary and which moreover does not appear to have any relation to what may be set by the Board of Referees under The Excess Profits Tax Act.

Interpretation of Financial Statements

In these times when propaganda is being put to various purposes, the form and content of a financial statement has to be doubly scrutinized, first from the viewpoint of its accuracy and adequacy, and then, even if it has stood up to these tests, to see whether it lays itself unnecessarily open to wrongful analysis or interpretation. Something like this was in the editor's thoughts when the January comments were prepared, and judging from correspondence received, they struck a responsive chord in other minds—but they do not all think alike. For example, Professor Smails, who edits our Students' section, gives in this issue an instance of another kind of interpretation, which is worth the attention of other readers as well as students. And, in support of our general idea we quote as follows from a letter received from a member who is identified with a large investing institution: "It was with a great deal of interest that I read the editorial comment in the January issue of THE CANADIAN CHARTERED ACCOUNTANT. Having to read a considerable number of financial statements, I was more than ordinarily interested in the material under the headings 'Successive Balances' and 'Interpretation of Statements'. If those who prepared financial statements would do so with the idea in mind that they can be easily understood, and would simplify them to the point of showing the essential information with proper explanatory wording, it would be of tremendous benefit to the investing public at large and I believe would make people generally, far more interested in the companies and what they are doing."

AUDITORS' REPLY ENVELOPES

A new order of the Wartime Prices and Trade Board (No. 332, respecting printed matter) includes the following clause 6: "No person shall print any return or business reply post card or envelope except an envelope designed for both original use and return." This would prohibit an auditing firm from securing new supplies of printed envelopes for use in confirmations.

The Dominion Association of Chartered Accountants accordingly made application, supported by letters from representative firms of chartered accountants, for a change in the order or for an exemption, so as to permit of firms of chartered accountants securing new supplies of printed return envelopes as required.

As a result, the Wartime Prices and Trade Board has made a ruling in this connection which allows auditors and firms of auditors to continue the use of reply envelopes specifically for the verification of accounts, providing they make individual application for them. The Board states, by letter dated 19th January 1944 from the Administrator of Publishing, Printing and Allied Industries: "We deem it advisable that no change in the order be made, but that the practice of allowing individual permission be continued, and if necessary you can notify members of your Association that this practice will be continued at least for the time being."

ASSOCIATION'S PRESIDENT HONOURED

Among the civilians to be honoured by New Year appointments announced from Ottawa, was Henry G. Norman, chartered accountant, and president of The Dominion Association of Chartered Accountants. He was made a Companion of the Most Distinguished Order of Saint Michael and Saint George.

The Preparation and Presentation of a Brief Before The Board of Referees

By E. C. Leetham
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Montreal, P.Q.

(An address delivered before a meeting of the Chartered Accountants Students' Society of the Province of Quebec on 14th January 1944 at Montreal.)

I DESIRE to thank the Chairman for his very kind introduction and to say how much pleasure it gives me to address the Chartered Accountants Students' Society of the Province of Quebec and their guests. The subject of my talk is one that has a special interest for accountants and business executives. Whether we like it or not, the government, through the medium of the Income War Tax Act and the Excess Profits Tax Act, has given us all a preferred partner in our business—Mr. Ilsley, Minister of Finance—one who participates in all the profits while the business takes all the losses.

Some years ago, in what I would call the "good old days" previous to 1940, when married persons had an exemption of $2,000 under the Income War Tax Act, an income tax assessor called upon a merchant in a small town and told him that he had neglected to file an income tax return. He inquired as to the meaning of an "income tax return". The assessor explained to him that if he made over $2,000 a year the government took a certain percentage of the amount in excess of the $2,000. The merchant then asked whether, if he made less than $2,000, the government would pay him a percentage of the difference. Of course, the assessor laughingly told him that would be impossible. So the merchant thought it over and finally said "Well, I don't think I'll join." By this time practically every person in the country is aware that he has no option but to "join the large tax-paying family of Canadians."

With rates of taxes at 75% and now 100% of the amount in excess of the average or standard profits in the period from 1936 to 1939 having to be paid to the government, the successful application for, and the receiving of,

an adequate standard profit from the Board of Referees, is possibly the most important and profitable work which can be undertaken by the executives of any company. It is obvious, therefore, that any time, effort or money spent in obtaining as high a standard profit as possible will pay handsome dividends, as long as the profits are such as to be taxed at the maximum rates. When a company is successful in receiving a standard profit from the board it is comparable to buying an annuity which represents the difference between the taxes payable on their factual standard and the standard profit awarded by the board. The importance of this is emphasized by the fact that since July 1, 1942, the maximum amount of earnings made since that date, which can be retained, is 70% of the standard profit.

Main Headings

This is a fairly big subject and two evenings have been allotted in which to cover the ground. I propose to deal this evening, as far as time will permit, with:

(a) Powers and duties of the Board of Referees;

(b) Companies which are able to apply for relief;

(c) Under what section of the Act application should be made;

(d) Date to be used for calculating capital employed;

(e) Date when applications have to be submitted;

(f) Preparation of the brief and supporting schedules.

Next week we will take up any part of the preparation of the foregoing which has not been covered this evening, as well as the personal presentation of the brief before the Board of Referees at Ottawa.

With few exceptions practically all business operated for gain in Canada comes within the provisions of The Excess Profits Tax Act, 1940. The exceptions are, generally, profits from a profession dependent mainly on personal qualifications with little or no capital employed; small businesses whose profits before providing for any remuneration to owners are less than $5,000; personal corporations, non-resident owned and diversified investment corporations; certain base metal mining operations, etc. While most businesses are liable to taxation under The Excess Profits Tax Act, only those which can prove to the satisfaction of the Minister of National Revenue

either that their earnings were depressed in the standard period, or that business was commenced after January 1, 1938, have the privilege of appearing before the Board of Referees for the purpose of making an application for a standard profit, as contrasted with a factual profit. Approximately 1,500 awards have been made by the board.

This talk will deal with incorporated companies, but, in general, the remarks will apply also to partnerships and sole proprietorships.

Work of the Board

Before the actual preparation of a brief for submission to the Board of Referees is undertaken it is necessary to have a thorough knowledge of:

(a) The powers and limitations under which the board performs the duties assigned to it;

(b) The provisions of the Act under which a request for relief may be made.

The Canadian government, on advice of the Minister of National Revenue, by order in council under date the 16th November, 1940 appointed a Board of Referees to advise and aid him in exercising the powers conferred upon him under The Excess Profits Tax Act.

The Board is absolutely non-political and at present is composed of the following members: Honourable Justice W. H. Harrison, chairman; Kenneth W. Dalglish, C.A., member; C. Percy Fell, member; Courtland Elliott, member.

The functions of the board are to "aid and advise" the Minister of National Revenue in the administration of The Excess Profits Tax Act and particularly to set a standard profit for any business whose earnings were depressed during the standard period 1936 to 1939. It is essentially a relief giving body. The board was created for the purpose of granting relief where no relief can be granted in strict law. The board has no restrictions placed on its discretionary powers, except that it must keep within the limits of the statute under which it operates. It must also hear the facts and give applicants every opportunity to present all necessary documents and evidence. It will be appreciated that, in framing a tax act which applies to such a great variety of businesses in Canada, many inequalities and injustices would arise.

The government considered that the base period which they adopted, namely the calendar years 1936 to 1939, represented a fairly average condition of business in this country. They felt that taxing profits at maximum rates on any increase over the standard would be equitable for most taxpayers. To provide for cases where the results of the standard period were unusually low, they appointed a Board of Referees, an independent body, to set standard profits in cases where a hardship would develop by taking the factual profits.

Standard Profits

Duties of the board are to set standard profits for established companies which were depressed in the standard period, and new companies which commenced business after December 31, 1937; also to calculate the amount of capital employed by companies appearing before them.

All companies which commenced business after January 1, 1939 must have their standard fixed by the Board of Referees. This is a mandatory provision. This amendment was made to the Act to provide for cases where a company might have a larger factual profit in 1939 than could possibly be received on application to the Board of Referees. Such companies are the only ones which might have a standard profit awarded by the Board of Referees of less than their one year factual profits.

The minister on request must refer to the Board of Referees the application of any new company which commenced business after December 31, 1937, and previous to January 1, 1939. The minister has no power to refuse this application. Such a company might decide that its average earnings for the time it has been in business in the standard period constitutes a satisfactory standard and therefore make no application to the Board of Referees.

There is a distinct difference in treatment between established companies in business previous to January 1, 1938, and new companies which commenced business after December 31, 1937, as the board is empowered to award a new company "an amount equal to a return on capital employed at the rate earned by taxpayers during the standard period in similar circumstances engaged in the same or an analogous class of business" *whatever the rate may be.* Under this section they are not limited to 10%.

The Minister may refer a taxpayer's claim for advice to the board as to whether, in their opinion, the taxpayer is depressed.

Limitations

In connection with presenting claims before the Board of Referees it should be understood that:

(1) Equalization of the burden of excess profits tax is not among the board's functions.

(2) In claims before the board they seek, on information supplied by the claimant, supplemented by staff studies, to set a level of profits which might reasonably have been earned under conditions in the standard period.

(3) The board cannot grant a standard profit higher than could possibly have been earned in 1936 to 1939 that would recoup losses of past lean years and fortify against future adversities.

(4) The board is not unmindful of the consequences of resulting taxation upon business, but its primary duty is to equalize the base, not the consequences, of the tax.

(5) The board remembers that most taxpayers subject to excess profits tax are not eligible to appear before it. Its duty, therefore, is only to set a base which represents a realistic judgment of what pre-war profits might have been if the claimant had been in business, or had not been unduly depressed.

It is important to have a sound and complete knowledge as to the powers of the board. It is useless to ask for relief on a basis which is beyond the jurisdiction of the board. If a company has never earned during its best pre-standard years more than 6% on capital, obviously it cannot expect to receive an award of 10% on capital, just because some competitors have earned that amount in prior years. Likewise a company which has never earned 5% on capital cannot expect the board to grant even the minimum rate of 5%. They would likely be left with their own standard in this case.

The idea that the board has to award the same return on capital for all companies in the same line of business is erroneous. Each company's case is decided on its own merits and presentation of its facts. Awards can vary from five to ten per cent even in the same industry. Just because an industry is depressed, it does not follow that

every company in that industry is depressed and can appear before the board. Each application is dealt with on its merits regardless of conditions in the industry.

The board looks back beyond the standard period to earnings of pre-standard years. Examination of earnings over a long period previous to the standard period is made, comparison is made with other similar concerns, and determination is then made as to what the business could reasonably have earned, after taking into account any changes in salaries, interest charges, etc., which might have affected earnings. Generally the earnings made in the boom years from 1926 to 1930 are disregarded or heavily discounted.

The board endeavours to correct loss of earning power due to temporary disabilities, *not permanent disabilities.* Such temporary disabilities might be as a result of a fire, flood, strike loss, difficulties of transportation, bankruptcy of a large debtor, crop failures, etc. If a company's earnings were greatly curtailed as a result of the change in the rate of duty which was still in effect in the taxation year, this would be a permanent disability and the company could not get relief from the board on this account.

The board has no power to reduce factual profits but can leave the company with their own standard. This is specifically provided for in the Act. The only exception is a company which commenced business after January 1, 1939, and having a fiscal period ending in 1939.

There are many cases of hardship under section 5(1). A company may be in an industry which may earn 20% on the average but it may have only earned 10% in the standard period; such a company is undoubtedly depressed as compared with others in the industry and consequently is in a poor competitive position, but under the wording of the Act the board cannot allow them more than 10% on capital employed.

In case of impaired and low capital, the board may correct the capital to a figure which, in their opinion, is required for the particular business and then strike a rate on such capital comparable to others engaged in that line of business.

It is impossible to lay down any definite rules as to facts which could be used to get favourable consideration

by the Board of Referees. The board is a discretionary tribunal and will consider any factors it sees fit when making its decision. When a standard profit is awarded by the board, the method used to arrive at the standard is never divulged.

Companies Which Are Able to Apply for Relief

1. Old established companies whose earnings were depressed in the standard period.
2. New companies which started operations after December 31, 1937.
3. New companies which started operations on or after January 2, 1939. Such companies *must* have their standard profit fixed by the Board of Referees, whether or not application is made by them. They cannot make application until they have had at least one year's actual experience.
4. A company applying as a new company by reason of an increase in capital employed to the extent of 33-1/3% of capital at the commencement of the year or fiscal period next preceding the taxation year, or last year of standard period.
5. A sole proprietorship or partnership which has been incorporated since December 31, 1937, thus qualifying as a new company.

Under What Section Application Should be Made

When the officials of a company consider that, in their opinion, their business was depressed in the standard period, under the terms of The Excess Profits Tax Act, the first thing necessary is to find out under which section of the Act they can best qualify for relief.

1. If the company has been in business previous to January 1, 1938, it might qualify under section 5(1) or section 5(3).
   - (a) Under section 5(1) the board is limited to an award of from 5 to 10% on capital employed.
   - (b) Under section 5(3) where claim is made that the business is of such a nature that capital is not an important factor in the earning of profits, or the capital has become abnormally impaired or due to other extraordinary circumstances is abnormally low, an award may be made on such basis as the

board thinks just, having regard to the standard profits of taxpayers in similar circumstances engaged in the same or an analogous class of business.

2. New companies which commenced business after December 31, 1937, or companies which have increased their capital by 33-1/3%, may apply under section 5(2) or section 5(3).

(a) Under section 5(2) the board will make an award on capital employed at the commencement of the first year or fiscal period in respect of which the company is subject to taxation under the Act at the rate earned by taxpayers during the standard period in similar circumstances engaged in the same or an analogous class of business.

(b) Under section 5(3) where claim is made that the business is of such a nature that capital is not an important factor in the earning of profits, or the capital has become abnormally impaired or due to other extraordinary circumstances is abnormally low, an award may be made on such basis as the board thinks just, having regard to the standard profits of taxpayers in similar circumstances engaged in the same or an analogous class of business.

If application is made under section 5(3) on the grounds that capital is not an important factor in the earning of profits or that capital has become abnormally impaired or due to other extraordinary circumstances is abnormally low, it is also necessary to prove that the awarding of a standard profit based on capital employed would result in the imposition of excessive taxation amounting to unjustifiable hardship or extreme discrimination, or would jeopardize the continuation of the business. It is not sufficient only to prove that capital is not an important factor in the earning of the income or that capital is abnormally low.

Date to be Used for Calculating Capital Employed

The method of calculating capital employed is fully set forth in the first schedule to the Act and it is not proposed to discuss this feature.

1. Companies in business previous to January 1, 1938, capital employed taken at the commencement of the last year or fiscal period within the standard period. Example: Year ended July 31, 1940—capital calculated as at July 31, 1938, not July 31, 1939, because part of the period ended July 31, 1940, extends into the taxation year.

2. Companies not in business previous to January 1, 1938, capital employed taken at the commencement of the first year or fiscal period in respect of which the company is subject to taxation under the Act—latest date December 31, 1939. For a fiscal period ended May 31, 1940, capital would be calculated as at May 31, 1939.

- (a) Board of Referees can only deal with a company, as a new company, if referred to it as such by the Minister of National Revenue.
- (b) Date of commencement of business of a new company is entirely within the discretion of the Minister of National Revenue.

The difference in the date for computing capital employed as between an established company and a new company is sometimes very advantageous for the new company, especially if the year 1939 happened to be a prosperous year for it, because benefit is received for all 1939 earnings retained in the business. Fiscal period ended December 31, capital employed for an established company would be taken as at December 31, 1938, and for a new company as at December 31, 1939.

Date When Applications Have to be Submitted

There is no time limit under which applications to the Board of Referees must be made. The standard profit granted by the board applies to all fiscal periods ending in 1940 and subsequently, with the exception that if a fiscal period since 1939 has already been assessed and is statute barred by the lapse of time in which to file an appeal, viz., after thirty days from date of assessment, then standard awarded would not apply to such period. This condition sometimes arises where a company is satisfied with factual standard in respect to 1940 profits and accepts assessment, but subsequently decides to ask for determination of a standard profit from the Board of Referees. If subsequently a standard profit is awarded by the board, same will apply for 1941 fiscal period and thereafter. Of course

a company still has twelve months to ask for relief. Under section 56 the minister may on application of taxpayer within twelve months from date of payment of tax or date of notice of assessment refund an overpayment. Another exception would be where a company has made application to the board as a new company on account of an increase in capital employed of over 33-1/3% since the standard period. A corporate business which was not in operation during the standard period might in 1942 add new capital stock to the extent of 33-1/3% of the capital employed at the beginning of the 1941 period and would thereby qualify as a new business in 1943.

The granting of a standard profit by the Board of Referees automatically rules out any increase in such standard by reason of an increase in capital employed during the standard period as is granted to companies using factual standard.

A company which has made application to the Minister of National Revenue to have a standard profit granted by the Board of Referees on account of depression, and subsequently receives notice that the request has been forwarded to the board, should not assume that the minister has decided that the company was depressed during the standard period, because the request might have been forwarded to the board for advice as to whether the company was in the opinion of the board depressed in the standard period, and if depressed a standard profit is awarded.

Preparation of Brief and Supporting Schedules

It will be appreciated that, in an article of this kind, covering all types of business operations, comments of necessity must be general in character. It is hoped that, from the general pattern, some assistance may be given in the preparation of a brief. It must be remembered, however, that each brief submitted must be "tailor-made" to fit the circumstances of each particular application.

Assuming now that the section under which application is to be made has been decided upon, then the preparation of the actual brief can be commenced.

1. It is suggested that five copies of the brief and supporting documents be prepared—three copies are required for filing with the government and it is desirable to retain two copies for the company's own use. First the official

form S.P.1 and Questionnaire combined must be completed in detail and duly signed by a qualified officer of the company. This form does not need further comment, except that no provision has been made on the form to set down the amount of standard profit requested. The amount of standard profit desired must be set forth in the brief. Some claims have been received by the Board of Referees without any indication as to the amount of standard profit requested.

2. State that the business was depressed during the standard period and indicate under what sub-section of section 5 of the Act application is being made and mention the standard profit desired. In addition, if applying under sub-section 3 of section 5, state that capital employed is not an important factor in the earning of income or that capital has become abnormally impaired or due to other extraordinary circumstances is abnormally low, and that standard profits ascertained by reference to capital employed would result in the imposition of excessive taxation, amounting to unjustifiable hardship and extreme discrimination, and would jeopardize the continuation of the business.

3. List the various schedules which are attached to the brief, which might include the following:

(a) Statement of capital employed prepared in accordance with the first schedule of the Act. (1) Company in business during standard period. Figures must be completed as at commencement of the four fiscal periods in the standard period or for such periods as the company was in business during the standard period. Capital employed statement also requested for as many pre-standard periods as are necessary to demonstrate earning power. (2) Company which commenced business after January 1, 1938, i.e., "new company within the meaning of the Act." Figures must be completed as at the commencement of the first taxation period. (3) New company by reason of new contributed capital to extent of 33-1/3%. Figures must be completed as at the commencement of the fiscal period of the company in the standard period next preceding the taxation year or as at the commencement of

the last fiscal year of the company in the standard period. (4) Companies filing consolidated returns. Statements should be prepared in columnar manner showing each constituent company separately, covering all four years of the standard period.

(b) Comparative earnings statement for several years back, say from 1926 up to and including last financial results available. The earnings should be related as a percentage of capital employed and grouped in appropriate periods, viz., 1926 to 1930, 1931 to 1935, 1936 to 1939, and 1940 to last financial year available.

(c) Comparative profit & loss account showing sales, cost of sales, gross profit, depreciation, bad debts, executive remuneration, sales expense, etc., from 1926, all related as a percentage of sales.

(d) Analysis of sales, by product groups, by years from 1926.

(e) Statement showing number of firms in your particular industry, capital employed, total sales and earnings of industry, at least from 1936. This information might be obtained from trade association figures or from Bureau of Statistics, Ottawa.

(f) Statement showing sales per dollar of capital employed in business, by years.

(g) If company depends mainly for its earnings on sales to another industry or industries which were depressed during the standard period, a statement should be prepared showing volume of business done by such industry from 1926. This statement could be related to the sales of the applicant during the same period. Canadians do not properly realize that they have literally a "gold mine" of information in the reports put out by the Bureau of Statistics. These reports are most helpful in preparing a brief because general information can be obtained covering practically every industry in the country. While no individual company figures are given by the Bureau of Statistics, the following valuable information can be obtained from their reports: (1) Number of firms in the indus-

try; (2) number of employees; (3) gross capitalization employed, showing how this is made up; (4) number of companies, divided by capitalization groups; (5) gross sales of products, divided by product groups; (6) salaries and wages paid; (7) names of firms in the industry.

(h) A new company might include statement showing what production might have been in each year of the standard period, if the company had been in business under normal conditions. This statement should be related to the market available and also should prove why applicant company considers that they could have profitably marketed the estimated production.

(i) A new company might have commenced manufacturing or selling a product which previously had been imported, in which case a statement might be prepared showing what assumed volume in standard period might have been, related to imports of the product, due allowance being made for increased volume on account of lower selling prices, better distribution facilities, etc.

(j) Occasionally there are no comparative companies in Canada doing a similar business to the applicant company, but if figures are available covering a foreign company, these might be submitted to prove standard requested.

4. A brief history of the business should be given, which might include:

(a) Date when business was commenced.

(b) Nature of the business transacted, indicating different products manufactured or sold or services rendered.

(c) Location of main plant and subsidiary plants or branches, if any. If company files consolidated return, list of subsidiaries should be given.

(d) Location of warehouses, distributing centres or sales outlets.

(e) Number of employees, if possible for each year from 1926.

(f) Give particulars of capitalization and changes made therein since incorporation.

5. The next point to prove is that the business during the standard period, for reasons peculiar to itself, was abnormally depressed in respect to all or any of the following:

(a) Sales.
(b) Net taxable earnings.
(c) Return on capital employed.

Reasons for Depression

Take up in detail the different reasons which resulted in the depressed conditions of the business. It is not sufficient to state that certain definite conditions caused the depression, but each point must be proved *beyond doubt* by reference to the information appearing on the different supporting schedules submitted.

Here are twenty-one reasons which might cause depression in the standard period in different types of industry. There are doubtless many more, but these should prove representative.

(a) Depressed conditions in the industry;

(b) Fire loss;

(c) Strike loss;

(d) Crop failure;

(e) Poor business conditions in customer's business, thus curtailing sales;

(f) Temporary loss of market through change in customs duty.

(g) Change in merchandising methods in industry;

(h) Raw materials not available, necessitating change to substitute materials;

(i) Excessive and unreasonable competition, either domestic or foreign;

(j) Price war between competitors;

(k) Development of new major lines of product during part of the standard period.

(l) Development of new lines under new patent rights during part of the standard period;

(m) Practically complete change in business operations during part of standard period;

(n) Excessive losses from bad accounts due to poor business conditions;

(o) Abnormal rise in cost of raw materials, without being able to increase selling prices accordingly;

(p) Acquisition by selling company of additional major lines and excessive cost in introducing them to the market during standard period;

(q) Change of management;

(r) Failure to obtain supplies through embargoes.

In addition, for new companies:

(a) Insufficient time in business in standard period to obtain normal volume of sales and demonstrate earning power.

(b) Excessive costs of manufacturing or selling in getting started in standard period.

Many of the causes of depression enumerated are self-explanatory, and the treatment necessary to show the depressed earnings is relatively simple.

Difficult Cases

We will now demonstrate how depression might be proven in some of the more difficult cases:

1. Development of new major lines of product during part of standard period;

2. Practically complete change in business operations during part of standard period;

3. Acquisition by selling company of additional major lines and excessive cost in introducing them to market during standard period;

4. Insufficient time in business in standard period to obtain normal volume of sales and demonstrate earning power. Show:

   (a) Growth of total sales and sales of new products in standard period or for that part of standard period during which new development has taken place, as compared with taxation period;

   (b) Growth of sales to individual customers during standard and taxation period;

   (c) Cost of introducing new products to the market during standard period as compared with taxation period;

   (d) Abnormal costs of development in standard period;

   (e) Assumed normal sales volume which could reasonably have been secured in standard period if new lines had been started in pre-standard period;

(f) Increase in gross profits and net profits on the increased assumed normal volume;

(g) Adjustment of standard profits for such increase in net profits demonstrating what standard profits might have been on such reasonable assumed volume;

(h) Relation between assumed increased sales to total available sales in the industry in standard period and prove why applicant company could have received this volume of sales.

5. Development of new lines under new patent rights during part of standard period.

(a) If applying under section 5, sub-section 3—capital not important factor—demonstrate that patent is major profit-making factor and prove it. Selling a patented article is costly in earlier years, depressing profits, but after public acceptance has been secured, sales increase geometrically and selling costs decline drastically.

(b) Compare the results of marketing the patented article in foreign country in standard period or pre-standard period.

(c) A capital value might be put on the patented article based on earning ability.

(d) Sales, gross profit and net profit might be related to machinery investment to demonstrate that machinery is an unimportant factor in the earning of profit.

6. Low profits in one or more standard years caused by a strike. Show:—

(a) Direct strike expenses;

(b) Loss of seasonal market;

(c) If strikers not re-employed, necessitating training of new help, show cost of training of new help;

(d) How product was imperfect due to untrained help resulting in excessive returns of sales;

(e) Excessive costs of manufacture, and selling costs in regaining market.

7. Raw materials not available necessitating change to substitute materials. In 1938 and 1939 many raw ma-

terials formerly obtained from foreign sources were stopped or seriously curtailed. Show:—

(a) Cost of research and laboratory costs in experimenting with substitutes;

(b) Extra costs reflected by decrease in standard profits on account of delays in production, faulty merchandise and high sales returns;

(c) What profits would have been in standard period if disabilities removed.

8. Excessive and unreasonable competition or price war between manufacturers. Show:—

(a) Decline in percentage of gross profits in standard period as compared with pre-standard period, as a direct result of unreasonable competition;

(b) Increase in actual standard profit by percentage of decrease in gross, showing what profit should have been realized but for unreasonable competition.

9. For a company applying for relief because of low capital it might be shown it has low capital in relation to the industry, as a whole, by comparison of:—

(a) Capital employed in relation to sales;

(b) Capital employed in relation to total investment;

(c) Capital employed in relation to fixed assets;

(d) Buildings and equipment may be rented as against custom of the industry of ownership of such assets.

Next week, as a continuation of this talk, we will take up special factors governing applications under section 5, sub-section 3 of the Act. As you are aware, this is one of the best sub-sections of the Act under which to qualify and, therefore, the proper handling of such applications is of paramount importance. The procedure surrounding the actual personal presentation of briefs before the Board of Referees at Ottawa will be fully covered.

Discussion

CHAIRMAN: We will now have a ten minute intermission. Mr. Leetham has consented to answer any questions and I would ask you to kindly write your questions on the paper which has been provided and hand them in promptly.

QUESTION: In the case of a new company, i.e. one

formed subsequent to January 1, 1939, can application be made for a standard greater than the actual profits for the first year of operation, provided such an application is based on reasonable ground?

MR. LEETHAM: Yes. In most new industries it takes from three to four years to get public acceptance of the product and realize normal volume of sales and normal cost of manufacture or selling expense.

QUESTION: If a company was assessed for the year 1941 and the standard of $5,000 taken, can an increased standard profit claim be filed for 1942 and 1943?

MR. LEETHAM: Yes. There is no time limit for filing of claims with the Board of Referees. If the company was assessed for the year 1941 and the appeal statute barred by reason of the lapse of the thirty-day limit, the standard profit awarded by the board would not apply for 1941, subject of course, to the rights of the taxpayer under section 56 of the Income Tax Act, wherein the minister may on application in writing from a taxpayer within twelve months of the date of payment of the tax, make a refund of any overpayment which has been made.

QUESTION: If a sole owner who incorporated on January 1, 1941, accepts, on enquiry from the local income tax inspector, the standard of his predecessor, can the company apply to the Board to have the standard profit revised?

MR. LEETHAM: As the company commenced business after January 1, 1939, it must apply to the board to have its standard profits established. Representations could then be made to have the standard profit of the sole proprietorship granted as the standard profit of the incorporated company.

QUESTION: A company adds a new department after January 2, 1939, changes its methods of operation, resulting in greatly increased profits. Since this recognized company is no longer comparable to the company existing in 1936 to 1939, can this company claim it is actually a new company and ask for a revised standard?

MR. LEETHAM: If there has been no change in capital employed and the only thing that has happened is that a new department has been added, this would not constitute a new company within the meaning of the Act, hence no

application could successfully be made to the Board of Referees.

QUESTION: A company started operations in 1940 and showed a profit of $1,800 in that year, $4,000 in 1941, and $11,000 in 1942. The low profits in 1940 and 1941 compared to the profits of 1942 were due to organization stages. What relief could be sought by claiming company? There is no similar manufacturing business in Canada.

MR. LEETHAM: The company must apply to the Board of Referees since it started operations after January 1, 1939. If you are asking me to tell you what standard they could hope to obtain from the board, I cannot do so, because it would require more detailed information than is submitted in the question. It takes three or four years for a company to get public acceptance of its product and reach its normal volume of sales. Manufacturing and selling costs are heavier in the first year. This could be brought out when making the application.

QUESTION: If a company has a 1/3 increase in capital employed and files as a new business, will the standard profits set by the Board be based on the earning record of itself or based on the earning record of an analogous company?

MR. LEETHAM: While the method of arriving at the standard profit by the Board of Referees is never divulged, it is my opinion that they would look at the earning record of the applicant company, as well as the earning record of any analogous companies in making their decision. In the presentation of the brief, the claimant company could stress either its own earning record or that of a comparable company, whichever was the most favourable.

Auditors' Reports

By T. D. H. Cox

Toronto, Ontario

(The second of a series of staff talks. Others to follow later.)

I HAVE divided this subject into three sections, first, special reports required under Section 114 of the Dominion Companies Act, second, the statutory report referred to in Section 120 of the Act and third, reports on sole traders, partnerships, associations, etc.

Section 114 deals with certain requirements regarding subsidiary companies when reporting on the accounts of the parent company where the financial statements of parent and subsidiary companies are not consolidated. It requires the auditor of the holding company to give certain information in connection with the profits or losses of the subsidiary company, but the words "profits" and "losses" are not very clearly defined in the Act, and this fact has given rise to a number of differences with clients, particularly in connection with the information required under sub-section 3 of Section 114. Generally speaking, we have interpreted "profits" to mean the profits of the subsidiary company for the fiscal year or period falling within the fiscal year of the parent company, but we have been consistently over-ruled by our clients' lawyers and by our own lawyers who maintain that they can only interpret the Act to mean the accumulated profits or losses, in other words, the surplus or deficit accounts of the subsidiary.

This produces an interesting situation. If we accept legal opinion it would be possible for a parent company to continue receiving dividends from a subsidiary that is losing money, but has a substantial surplus account, without any indication to the shareholders of the losses being incurred by the subsidiary. In fact this could be carried on, without the auditor saying anything, right up to the point where the dividends and losses had entirely wiped out the surplus of the subsidiary, and then the shareholders would suddenly have to be informed of the true position. We contend that this is certainly not good practice, irrespective of the provisions of the Act, and I believe we should

report on the dividends received by a parent company from a subsidiary company in any year in relation to the subsidiary company's earnings for the same year and clearly indicate in our report either of the following: (a) That the dividends are less than the earnings of the subsidiary company for the year and that the balance had been added to the surplus or deducted from the deficit of the subsidiary; or (b) that the dividends exceed the subsidiary company's earnings for the year and that the excess has been provided out of its surplus account. The accumulated profits and losses, or surpluses and deficits, of the subsidiary will automatically be taken care of when considering the valuation of the investment in the subsidiary company on the parent company's balance sheet. A deficit reducing the net worth of the subsidiary company below the valuation on the parent company's balance sheet requiring an adjustment or a qualification in our report.

Director's Report

Another interesting point in this section of the Act is the provision that when the auditor is unable to get the required information regarding a subsidiary company, the directors must attach a report. The subsection of the Act reads as follows—

> If for any reason the directors of the holding company are unable to obtain such information as is necessary for the preparation of the statement aforesaid (the auditors' statement), the directors who sign the balance sheet shall so report in writing and their report shall be annexed to the balance sheet in lieu of the statement.

I have in mind one such case where the client and their legal advisers contended that if the directors make their report then there is no necessity, under the Act, for us to make any further comment. Consider what this means. In the case of the company in mind, there was no information as to the worth of the subsidiary company or its earnings. The subsidiary company was situated in South America and war restrictions prevented it from forwarding its financial statements. This would have meant that we would have given the usual statutory report stating that the balance sheet showed a true position and assumed that the shareholders would consider our report in conjunction with the qualifications contained in the directors' report also annexed to the balance sheet.

This is not a very happy arrangement and it seems to

me that the auditors must also refer in their report to their lack of information of the subsidiary company's earnings, either by a definite statement, or at least by a reference to the directors' report.

It should also be borne in mind that the parent company being dealt with may in turn be the subsidiary of another Canadian or foreign company. If owned by a foreign company not familiar with the Canadian Companies Act, there might be the danger of the situation being misunderstood, due to the absence of any qualification in the auditors' report on the subsidiary company.

There is one further point about this section. It requires the auditor of the holding company to repeat in his report any qualifications of the auditor of the subsidiary company. I think we should not take this too literally. There may be serious qualifications dealt with as footnotes, or by references to contingent liabilities and, here again, we should be guided by the facts and not the letter of the Act.

Statutory Reports

Section 120 requires certain statements by the auditor.

> The auditors shall make a report to the shareholders on the accounts examined by them and on every balance sheet laid before the company at any annual meeting during their tenure of office and the report shall state—(a) whether or not they have obtained all the information and explanations they have required, and, (b) whether, in their opinion, the balance sheet referred to in the report is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs, according to the best of their information and the explanations given to them and as shown by the books of the company.

From an examination of published statements it appears that when there are no qualifications the auditors' report is generally a repetition of the wording of the Act. I would like to suggest that the exact wording should be carefully considered to see that if under present legislation the auditors' report actually conveys the proper impression to shareholders. As an example—fixed assets may be properly shown in accordance with the Companies Act at their original cost with depreciation reserves clearly shown as a deduction, but do shareholders realize from our report that the net value of these assets as shown on the balance sheet may have no relation to their actual value?

It has also been noted that reports sometimes give a

statement of the extent of the examination conducted by the auditors usually along the following lines:

> We have examined the books and accounts of .... as at .... In this connection we examined and tested accounting records of the company and supporting evidence and made a general review of its accounting methods and of the operating and income accounts for the year, but we did not examine the details of all transactions.
>
> We report that, in our opinion, the above balance sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs according to the best of our information and the explanations given to us and as shown by the books of the company.

A comment of this nature may very likely be misunderstood and may cause unwarranted doubts as to the value of the report. The shareholders are not informed that the auditor has been satisfied as to the efficiency of internal controls, etc., and may have difficulty reconciling the qualification in the first paragraph with the report in the second paragraph.

If it is considered that the wording referred to must be used instead of the usual unqualified statutory report, then it might be amplified to inform the shareholders that, although all minor details were not checked, the auditor has been generally satisfied regarding the state of the affairs of the company. This must be so, of course, when the auditor signs the report, but it does not appear to be clearly enough indicated to the shareholders.

Sole Traders, Partnerships, Associations, Etc.

The auditors' report on financial statements coming under this heading are not directly subject to legislation. As a result, they appear in widely different forms. Sometimes there is merely a covering letter and others still use the expression "Audited and Verified".

Although there may be no statutory requirements governing the form of report to be made on financial statements of this type, I would suggest that the auditors should give some expression of their opinion of the correctness of the statements reported upon. The suggested report need not necessarily follow the form of a "statutory report", but I think it should, by the use of clear and definite wording, indicate that the statements properly set forth the financial position and/or the results of operations.

Reserves and Provisions

THE Council of the Institute of Chartered Accountants in England and Wales has issued a series of recommendations on accounting principles. Number 6 of the series, dealing with "Reserves and Provisions", is of special interest at the present time, and is reproduced below from "The Accountant" of October 23, 1943, followed by a special article from the October 30th issue of the same magazine.

The Recommendation

"A true appreciation of the financial position of a company as disclosed by its balance sheet may be rendered difficult or even impossible owing to lack of information as to the extent of undisclosed reserves and to insufficient distinction being made between (a) free reserves retained to strengthen the financial position or to meet unknown contingencies; (b) capital reserves or other reserves not normally regarded as available for distribution as dividend; (c) provisions for known contingencies; and (d) provisions for diminution in value of assets in excess of normal or estimated requirements.

"The terms 'reserves' and 'provisions' are commonly regarded as interchangeable. Accounts would be more clearly understood if the term 'reserve' were applied only to reserves which are free, and the term 'provision' were confined to amounts set aside for specific requirements.

"Unless the amounts involved are stated, the trend of profits may be obscured by transferring amounts to or from undisclosed accounts of the nature of free reserves, by charging abnormal provisions or by utilizing provisions no longer required.

"It is therefore recommended that:

"(1) The following distinction should be made between reserves which are free and those in the nature of provisions for specific requirements; the latter should preferably be described as 'provisions':

> "(a) The term 'reserve' should be used to denote amounts set aside out of profits and other surpluses which are not designed to meet any liability, contingency, commitment or diminution in value of assets known to exist as at the date of the balance sheet.

"(b) The term 'provision' should be used to denote amounts set aside out of profits or other surpluses to meet: (i) specific requirements the amounts whereof can be estimated closely; and (ii) specific commitments, known contingencies and diminutions in values of assets existing as at the date of the balance sheet where the amounts involved cannot be determined with substantial accuracy.

"(2) Reserves, as defined in (i) (a) above, should be disclosed in the balance sheet.

"The term 'reserve fund' should only be used where a reserve is specifically represented by readily realizable and earmarked assets.

"Where two or more reserves are retentions of distributable profits available for general use in the business and none of them is created in accordance with statutory requirements or in pursuance of any obligation or policy, the subdivision of such reserves under a variety of headings is unnecessary. Capital and other reserves not normally regarded as available for distribution as dividend, should, however, be separated from those of a revenue nature, the latter group to include any undistributed balance, or, by deduction, any adverse balance on profit and loss account.

"(3) As a general principle 'provisions' as defined under (1) (b) (ii), should be disclosed in the balance sheet under one or more appropriate headings. Only in circumstances where disclosure of the amount of a particular provision would clearly be detrimental to the interests of a company should it be included under another heading, for example 'creditors'; the fact that such heading includes 'provisions' should then be indicated in the narrative.

"Where practicable, fixed assets in existence at the date of the balance sheet should be shown at cost, and provisions for depreciation and for diminution in values should appear as separate deductions therefrom.

"(4) Subject as in (3) above in regard to provisions the disclosure of which would be detrimental to the interests of a company, where reserves and provisions are created or increased, the amounts involved, if material, and the sources from which they have been created or increased, should be disclosed in the accounts. In all cases

the utilization of reserves, and of provisions proved to have been redundant, should be disclosed in the accounts."

Article from "The Accountant"

The following is the article from "The Accountant" of October 30th, 1943:

"The publication by the Council of the Institute of the sixth of its series of Recommendations on Accounting Principles, this time on 'Reserves and Provisions' . . . . constitutes a very notable landmark in accounting history. On this subject not only is there a bewildering, and very detrimental, variety of practice, but the text-books themselves speak with contradictory and ambiguous voices; and, in the absence of any unexceptionable source of authority, accountants called upon to advise have hitherto been obliged to rely on their own judgment, which may often have been found to be at variance with opinions expressed with equal honesty and ability by other members of the profession.

"The recommendation now published can hardly be expected to remove all difficulty from a peculiarly intractable subject; nor can it hope to deal with every variety of problem which practice brings to light. Let anyone, no matter how richly endowed with the gift of clear thinking, sit down to express in few words principles of universal application, and he will at once discover the difficulty of avoiding, on the one hand, the vagueness of mere unhelpful generalization and, on the other, the diffuseness of too much particularity. It is therefore unlikely that the language used by the Council will please all readers or provide a ready solution for all difficulties but, in our view, a successful attempt has been made, in courageous and progressive fashion, to give a lead and to provide a foundation of authority on which particular cases can be judged.

"The advice given is again expressed to represent only what is regarded 'as the best practice'. It binds nobody and clearly recognizes that the maxim that 'circumstances alter cases' will never cease to apply to accounting as a science applicable to all cases. More emphatically, the recommendation does not fetter the discretion with which law and practice have endowed auditors, nor does it derogate from the responsibility of directors to safeguard in

the last resort the interests of the companies for which they act. Further, it will not be overlooked that the statement applies only to 'companies engaged in industrial and commercial enterprises'; financial undertakings are, by implication, excluded and, if so, the edge of some possible criticism on the score of zeal may be blunted.

"The recommendation is carefully drafted to touch on three main points. There is the distinction between reserves and provisions; the creation, disclosure and utilization thereof; and the question of the disclosure of the original cost of existing fixed assets. Of these matters the first embodies a distinction which has long cried out for resolution. Accountants have always been aware that one of the foremost canons of accounting criticism is that a credit balance representing undistributed profits, withheld from dividend under varying degrees of choice or necessity, is a matter of wholly different significance from a credit balance held to answer a specific purpose or diminution of asset values; yet nomenclature honoured (or dishonoured) by long use, has, in a multitude of instances, failed to throw this vital distinction into relief and positively dangerous confusion has often arisen. It will be granted, we believe, that at least the criterion of the proper distinction has now been laid down. Doubtless there are sets of facts in practice where the line is narrow, but that does not destroy the distinction itself any more than the doubtfulness of the precise moment when day becomes night prevents us lighting our lamps. A 'reserve' is now defined as 'not designed to meet any liability, contingency, commitment or diminution in value of assets known to exist as at the date of the balance sheet'; while a 'provision' is for 'specific requirements the amounts whereof can be estimated closely and specific commitments, known contingencies and diminutions in values of assets existing as at the date of the balance sheet where the amounts involved cannot be determined with substantial accuracy'.

"Next comes the simple pronouncement which is surely the *clou* of the whole matter; 'reserves . . . . should be disclosed in the balance sheet'. When we think of the decades which have been spent in controversy, often quite acrimonious controversy, about secret reserves (we call a spade a spade and use the language of non-professional discussion) we are amazed at the boldness of the stroke

and the cleanness of the cut which has shorn away the lumber of the years. Notice that the direct method of statement has been chosen and that thereby the matter has been lifted from the dusty atmosphere of controversy; the Council has not stooped to condemn obscurantism; it has been content, and wisely content, to lift our attention towards an ideal.

"And when, in a new alignment of opinion, that ideal is contemplated, how natural it does seem. What, after all, is the purpose of an account if not to reveal facts and explain their bearing? Who, it may pertinently be asked, can prove that any harm has come to him through publishing a full and honest account? Nay more, who can deny that the real harm has come from the practice of concealment, cumulatively enforcing yet more concealment, until at last exposure brings disillusion and distrust? If only the virtues, and the material advantages, of candour can be preached and accepted, how great may be the uplifting of the status and public respect accorded to the visible results of accounting. Hitherto those who would listen to the voice of sweet reasonableness have been, perhaps justifiably, intimidated by the thought that if they are alone in leadership of progress they may suffer in competition from those who may take advantage of their virtues; but if, in consequence of the recommendation now made, all submit to the test imposed, the fear of victimization is at last reduced.

"A very striking point embodied in the recommendation is the decision that a debit balance on profit and loss should be deducted from reserves. Will practice so develop this that such a balance will be deducted from issued capital if no reserves exist?

"We remark that the suggestion that the word 'fund' should be used to connote the existence of an earmarked corresponding asset is well abreast of current opinion. Will the Company Law Amendment Committee take the hint, we wonder, in regard to the notorious statutory Capital Redemption Reserve Fund?

"Provisions stand on an entirely different footing. These are balances set aside to answer a reasonably imminent possibility. We remark, incidentally, that we do not think the Council has it in mind to suggest that so-called 'provisions' for accruing expenses should be disclosed; for

these are so akin to debts as to be outside the true conception of a provision. We apprehend that there may be questioning in some quarters about the reservation justifying non-disclosure where publicity 'would clearly be detrimental to the interests of a company'. We can think of one instance which may stand as an illustration of all; resistance against a disputed claim may be felt to be weak, yet to disclose that the whole amount has been provided for would obviously encourage the claimant and prejudice the defence; in such circumstances it would be manifestly unfair to expect that theoretical propriety should take precedence over self-interest.

"In our view the boldest innovation in the statement is the recommendation that 'where practicable' the cost of fixed assets should be shown, less the full amount provided for depreciation to date. If this is answered in practice it seems to us that fully 99 per cent. of balance sheets will change their form. The advantage in presenting a history of events is obvious and it will become possible to compare original cost with the unexpired value. But it would be a mistake to confine attention to the obvious case of plant and machinery. The recommendation seems equally to be aimed at sums devoted to the writing down of goodwill, the most frequent instance of the concealment of the utilization of profits.

"Finally, the recommendation makes imperative demand that the bringing back to profits either of reserves or of redundant provisions should be plainly stated. We need hardly remind our readers that if this view had been authoritatively expressed before 1931, the occurrence of such an episode as the Royal Mail case would have been impossible. We think that that case effectively set up a revised practice which the Council now underlines and endorses, but it is well to have it 'on the record'.

"In congratulating the Council on the step it has now taken we wish to express, we believe on behalf of the whole profession, our sense of indebtedness for the labour and care which must have been put into the preparation of this carefully worded and soundly constructed document. Opinions on these matters have many shades, and it must have been extremely difficult to crystallize into one statement a representative conspectus of them all. Having waited for some months since the previous issue, we now understand

how much work must have been going on within the district societies and at the Institute and, we suspect, on the part of the Taxation and Financial Relations Committee. We cordially wish the recommendation the success it deserves and we hope it will result in the co-ordination of published accounts within the limits of the subject with which it deals. Other work lies ahead for, obviously, the field of balance sheets, and more particularly of profit and loss accounts, has not been touched. It seems to us that a good job of work has been well begun and we look with sympathetic interest to its continuation."

EXCESS PROFITS TAX ON NEW GOLD MINES

In connection with section 5A, of The Excess Profits Tax Act, which section was enacted in 1942 to provide special treatment for new gold mines, the Commissioner of Income Tax issued in May, 1943 the following memorandum incorporating a formula for calculating standard profits:

A strict application of this section would result in the increase in the price of gold per ounce in the taxation period over the price per ounce in the standard period being deemed to be excess profits entirely as no consideration is given to variations in costs as between years.

In order to overcome this difficulty this Division and a committee acting on behalf of a representative number of new gold mines have worked out and have agreed upon the following formula for calculating standard profits under this section.

1. Presumed revenue—presumed selling price of gold, $35.38 x number of ounces produced in the taxation year.
2. Presumed cost—

(a) $\dfrac{100}{\text{Adjusted C. of L. Index averaged over fiscal year}}$ x Operating Costs in Taxation year.

Plus

(b) Write-offs in the taxation year in respect of depreciation and pre-production expenditures.

3. Total presumed cost	Items 2(a) and 2(b)
4. Presumed profit	Item 1 minus item 3
5. Deduct depletion	One-third of item 4
6. Standard profit	Item 4 minus item 5.

The only item in the above which requires an explanation is 2(a). The figure 100 is the base and represents the adjusted cost of living index for August 1939. The cost of living indices for subsequent months, which are given on a separate sheet attached hereto, are shown as a percentage of such base. The adjusted cost of living index averaged over the fiscal year means just what it says. If the company's fiscal period of twelve months are taken for the twelve months from April 1940 to March 1941 added together and divided

by 12, the resulting figure is the average adjusted cost of living index for the company's fiscal period.

'Operating Costs' will include all ordinary and regular costs, including marketing costs, but not depreciation, pre-production expenses and depletion, which are to be shown separately (see Items 2(b) and 5 of formula). The revenue from silver and other recoveries will be deducted from 'operating costs', such recoveries being treated as by-products.

The effect of this formula is to reduce the actual costs of the taxation year to a presumed standard period cost by eliminating the increase in the taxation year's operating costs over what the said operating costs would have been in August 1939.

Dominion Adjusted Cost of Living Index
(August 1939=100)

	1939	1940	1941	1942	1943
January	——	103.0	107.4	114.5	116.2
February	——	103.0	107.3	114.8	116.0
March	——	103.8	107.3	115.0	116.3
April	——	103.8	107.7	115.0	116.7
May	——	104.1	108.5	115.2	——
June	——	104.1	109.6	115.8	——
July	——	104.8	111.0	117.0	——
August	100.0	105.1	112.8	116.8	——
September	100.0	105.6	113.8	116.5	——
October	102.7	106.2	114.6	116.9	——
November	103.0	106.9	115.4	117.7	——
December	103.0	107.1	114.9	117.9	——

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	31st December 1943	*15th January 1944*
U.S. Dollars	10-11% P.	10-11% P
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indies—Dollars	9270	9270
India—Rupees	3356	3356
Hong Kong—Dollars (Custodian rate)	2781	2781
Straits Settlements—Dollars (Custodian rate)	5226	5226
Sweden—Kronor	2635	2635
Switzerland—Francs	2568	2568

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

Current Accounting Literature

A Summary Prepared by J. D. Campbell

Chartered Accountant

BULLETINS

Cost Accounting

BULLETIN No. 7, Volume XXV, 1st December 1943, published by the National Association of Cost Accountants (385 Madison Avenue, New York) contains two articles; the one deals with suggested relationships which should exist between government and business in the post-war period, the other discusses the tax problems arising from the annual concept of tax accounting.

Risk taking and the post-war period—Ralph E. Flanders in the article "Business and Government in the Post-War World" sketches a broad outline of a post-war program against a background of an historical survey of the relationships which have existed between business and government, which "we must keep in sight if we are to be successful".

The major broad requirement considered is that business shall be willing and able to return to its old function of taking risks. In order to provide for this requirement the necessity of removing the existing laws which are directly counter to this requirement must be reviewed. "Some solution can and must be found which will both offer reward to the risk-taker and return to the federal government its necessary income."

In covering the general question of risk taking and the individual it is pointed out that, although a highly industrialized civilization results in a higher standard of living, it subjects the individual to risks beyond those which existed in the simpler society. On this account the suggestion is made that the individual in the post-war era should be insured against the "disasters which are inherent in the economic system under which we live and over which he has no control", which insurance will act as a floor assuring a minimum of the necessities of life.

Annual concept vs. tax accounting—Randolph E. Paul in an article "The Annual Concept of Tax Accounting" discusses the general problems which arise in balancing equity with simplicity in tax legislation under conditions where

the tax legislation is based on the concept of periodic income: "The annual concept of tax accounting has a great deal to do with simplification. That is because it is a factor which leads to complexity .... The Treasury and business are sometimes agreed that a certain degree of complexity is legitimate, that it is even desirable when the outcome is a compensating equity."

A general historical outline is presented of the respective complexities which have arisen out of the period requirement of tax accounting covering the questions of accruals, inventories, and carry forward and carry backward provisions. Each of the questions is discussed briefly.

The question of the problems which are likely to face us in the post-war period has led to the suggestion that definite steps be taken to obliterate the present rather straight jacket distinction between taxable years. Various means are suggested as to how this transformation is to be made effective, among which are set out the allowance of reserve deductions.

In summing up, Mr. Paul sets out: "The sum of many expedients has given us both greater equity and greater complexity. Justification for complexity must be found in the inequities which we thereby seek to cure. Complexity carried beyond proper bounds may become an inequity in itself. On the other hand, simplicity may destroy more than it fulfils."

Post-war planning—Volume XXV, No. 88, 15 December 1943, published by the National Association of Cost Accountants, carries an article "Accountant's Responsibilities to Management in Planning for Reconversion and Post-War Progress", by Harry E. Howell, in which three distinct steps are outlined and discussed, covering the general problem of planning for post-war operations.

Against a background of the general responsibilities of accountants to management, in which are stressed the presentation of cost and financial problems which loom ahead coupled with the preparation of material which will aid management in making decisions covering the problem, the article outlines the three major steps which might be taken by the accountant in meeting this responsibility. "These then are the three steps—projections of financial budgets, of balance sheets, and of profit and loss statements, with the correlated analysis of problems and assumptions—that

will bring post-war planning down to a tangible, solid footing."

The problem of the preparation of the cash forecasts represents the preparation of a series of financial budgets (projected yearly source and application of funds statement) under varying assumptions based on the management estimate of what the projected conditions will be. Certain specific factors particularly applicable to the United States picture are discussed, covering tax refunds arising from carry forward and carry backward provisions, amortization of unused defence facilities, post-war refunds, and unused excess profit tax credits.

The second step, dealing with the measurement of financial strength, covers a general discussion of special facts which must be borne in mind in evaluating the concern's financial strength. "Never was there a time when a critical, unsentimental and objective appraisal of the balance sheet was more necessary or more profitable." Special items of tax liabilities, deferred repairs, new lines, unfinished contracts, and price inflation and obsolescence as applied to inventories, are discussed.

The third step in essence is an evaluation of the projected conditions as to their impact upon the profit possibilities of the concern. Cost control is discussed in detail and the conclusion is drawn "that the principle of standards and the control of operations through exceptions and variances is still the corner-stone".

From the specific, the article closes by reference to the general or broad background in which due weight is given to the significance of the certain economic aspects in any plan designed.

Accounting

Depreciation—Accounting Research Bulletin No. 20 on "Depreciation", issued in November 1943 by the Committee on Accounting Procedure of the American Institute of Accountants, is published in the December 1943 issue of *The Journal of Accountancy* (13 East 41st Street, New York).

The bulletin takes the form of a report of the Committee on Terminology, in which a discussion is presented of the definition "depreciation accounting" followed by a description of the various senses in which the words "depre-

ciate" and "depreciation" are used in connection with such accounting.

" 'Depreciation accounting' is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. 'Depreciation for the year' is the portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be a measurement of the effect of all such occurrences."

The Committee on Depreciation of the National Association of Railroad and Utilities Commissioners has issued a report on the subject of "Public Utility Depreciation" which is published in the December 1943 issue of *The Journal of Accountancy.*

The subject is subdivided under the following main headings, each of which is discussed in detail: Nature of depreciation; depreciable and non-depreciable property; basis of computing depreciation; depreciation methods; current charges and adjustment of reserves; depreciation in income taxation; depreciation and the investor; depreciation in rate making; and, responsibility of management and public accountants.

In covering the general subdivision of "depreciation methods", it is pointed out that although several methods have been used to compute public utility depreciation, such as the straight-line, compound-interest, and sinking fund method, "the straight-line method is generally recommended for public utility accounting and financial purposes and also for the computation of both depreciation expense and accrued depreciation for purposes of rate making."

In indicating the responsibility of management and public accountants, it is pointed out that they "have a responsibility to indicate in financial statements the proper depreciation expense and the reserve requirement according to their best information after appropriate study, in those instances where the book figures are inadequate or excessive in material amount."

ARTICLES

Pay - As - You - Go

Walter Hill in an article on Britain's "Pay-As-You-Go Plan" published in the December 1943 issue of *Taxes—The Tax Magazine* (Commerce Clearing House Inc., 214 N. Michigan Ave., Chicago), outlines briefly the salient points of the system of income tax collection which is to be introduced by the British government at the beginning of the financial year 6th April 1944.

The purpose of the plan is essentially the same as the underlying purpose of the Canadian plan. "All persons paid weekly will pay tax at the end of each week on their earnings during that week. The tax deducted by the new method will vary with earnings and avoid the accumulation of arrears."

The plan is based on a cumulative principle, that the amount of tax to be deducted for any given week will amount to the tax due on the total wages received in the financial year up to and including that week less the tax already deducted for the preceding weeks of the financial year.

On 6th April 1944, when the new plan begins to operate, the wage earner will be considered to have discharged his tax liabilities covering his past earnings. The previous deferred liability which existed will be "forgiven."

Although the plan represents an important improvement in the system of tax collection in Great Britain, it has the drawback of being confined in its application to weekly wage-earners.

Auditing Government Contracts

Frank E. Wood in an article "Auditing of Government Sub-Contracts" published in the November 1943 issue of *Cost and Management* (66 King Street East, Hamilton), discusses in detail the procedure which is followed in making the routine cost audit based on "M & S 433—Cost of Performing a Contract or Sub-Contract".

The general procedure outlined is broken down under the headings of: Scope of examination; direct materials; direct labour; direct engineering labour; direct factory charges; indirect costs, subdivided as between depreciation, property taxes, rentals and insurance and miscellaneous

indirect expenses; administration and general expenses; and expenses not allowable as costs.

"Perhaps the most important and incidentally the most difficult, is equitable allocation of overhead in plants engaged concurrently in war and commercial work. A straight productive labour basis, is of course, full of pitfalls and if adopted in toto, in many cases would be most unfair to either the contractor or the Department. Therefore, we endeavour to deal with each audit on its own merits and to apply whatever basis or combination of bases seems most equitable in the light of our experience and best judgment."

Bond Discount and Premium

Simon S. Lawrence in an article "Bond Discount Treatment Under the 1942 Revenue Act" published in the December 1943 issue of *Taxes—The Tax Magazine* outlines the treatment which is accorded bond premium under U.S. tax laws, and indicates the necessity for similar provisions covering the antithesis of bond premium, namely bond discount.

In viewing the U.S. tax provisions it must be borne in mind that capital gains and capital losses are taxable, a provision which does not apply to the Canadian situation.

The U.S. taxpayer has the election: (1) Of amortizing the premium on fully taxable bonds so that the current annual taxable income is the annual yield of the bond; or (2) of reporting the coupon rate as taxable income and deducting the premium as a capital loss at maturity or prior sale. In the case of a tax exempt bond the premium at maturity or prior sale may not be treated as a capital loss.

Throughout the article special care is taken to stress the fact that amortization of bond discount and bond premium represents a sound accounting principle. It remains with the Canadian courts to decide whether or not sound accounting principles are to be applied to the treatment of the item of bond discount and premium in our Canadian tax structure.

Internal Auditing

William W. Werntz in an article "Viewpoint of the Securities and Exchange Commission on Internal Auditing" published in the December 1943 issue of *The Journal of Accountancy* discusses the relative function of internal

auditing, both within the business enterprise in actual accounting performance and externally in the form of a liaison with the independent auditor.

Although the external auditor provides a reasonable assurance of accuracy in his certification of a company's statement, management assumes the major responsibility in the preparation of reasonably informative financial statements. In order to meet this responsibility, management must set up suitable internal procedures for the collecting and recording of financial information in order to insure its reliability and efficacy. "The Commission exercises no direct jurisdiction over internal accounting controls but is aware of the important part they play in fostering more accurate and dependable financial statements."

The various benefits to be derived by a concern from a system of internal audit are discussed, covering the elimination of unintentional inaccuracies as well as carefully planned fraud, and the protection afforded dealing with that type of transaction which is not covered by ordinary system of internal check or where collusion renders the internal controls ineffective. "A sound system of internal auditing appears to us to be one of the most efficient means of securing high levels of accuracy in the handling of routine business transactions."

The complementary nature of the work of the external and internal auditor is discussed, particularly as applied to conditions arising from the present war situation. "Each renders a distinctive service that cannot be entirely performed by the other."

Graphics

Joachim Silbermann in an article "How to Illustrate an Annual Report" published in the December 1943 issue of *The Journal of Accountancy* discusses the various types of graphic presentation of company information which might be utilized in reports published for the shareholders. The article is supported by special illustrative material covering the various uses discussed.

Standardized Accountancy

F. W. LeB Lean in an article "Standardized Accountancy in Germany" published in *The Accountant* (London) Vol. CIX, No. 3596, of 6th November 1943, presents a critical review of study prepared by Dr. Singer on this

particular topic. "This book . . . . provides . . . . an illuminating insight into the conscious effort of the German government, over several years past, to harness the whole of German industry into one co-ordinated effort towards maximizing production and directing it through the channels dictated by political expediency."

The object of the system described represents group regimentation controlled from the top and designed to increase output. Industry is organized into groups to which are allocated the items of productive wages and general manufacturing expenses. Standards of comparison are built up on a basis of fixed prices rather than ascertained costs, which process is designed to eliminate the question of monetary variations affecting market prices. "The system outlined by Dr. Singer may suit a nation that welcomes regimentation, fixed prices and state control, but I contend that it is not suited to British temperament."

Cost System

F. Osborn in an article "Inauguration of a Cost System" published in the July-September issue of *The Cost Accountant* and reprinted in the November 1943 issue of *Cost and Management* outlines the general procedure to be followed in setting up a cost system.

The article is divided into two main subdivisions. The first subdivision covers the field in general with a detailed discussion under the specific headings of fixing a goal, acquiring knowledge, drafting the general set-up, determination of the information required, determination of the personnel and equipment required, and application of the drafted layout. The second subdivision covers the more detailed aspects and problems in the same field under the general headings of wages, materials, and overhead, with special attention to the item of wages.

In discussing the item of wages it is pointed out that "the pillar on which I base my wages allocation is that of accuracy in the analysis of the wages account . . . . Only a small under or over recovery of wages is allowed." Certain specific problems covering wages which have been encountered are discussed and the solutions which have been applied are indicated.

Letter to the Editor

AN INCOME TAX SURVEY

Dear Sir:

In the address on the above subject given by Mr. Molyneux L. Gordon, K.C., at the meeting of The Institute of Chartered Accountants of Ontario, on November 25th, 1943, as reported in the January, 1944, issue of the magazine, there appears the following sentence (see page 7, last line): "The first mention of obsolescence appeared in the English statutes in 1926; but in Canada we are still further behind."

From an interest point of view, I submit the following:

Income Tax Act 1918, Schedule D.,
Cases I and II, Rule 7

"7. In estimating the profits or gains of any trade, manufacture, adventure, or concern in the nature of trade chargeable under this Schedule there shall be allowed to be deducted as expenses incurred in any year so much of any amount expended in that year in replacing any plant or machinery which has become obsolete as is equivalent to the cost of the plant or machinery replaced after deducting from that cost the total amount of any allowances which have at any time been made in estimating profits or gains as aforesaid on account of the wear and tear of that plant and machinery, and any sum realised by the sale of that machinery or plant."

Respectfully submitted,

January 13, 1943. GEORGE MUIR.

Mr. Gordon's Comment

In connection with the above letter, Mr. Gordon states: "The amendment was first introduced by Sec. 24, Sub-Sec. 3 of the Finance Act, 1918, which was passed on 30th July 1918 and was included in the Consolidated Act which was passed on 8th August.

"In checking this matter I have the amendment underlined but apparently there was a clerical error in transcribing the same because in my paper I referred to the Finance Act of 1926 which contains no such amendment instead of the Finance Act of 1918 which includes the same.

"It is most pleasing to know that people are sufficiently interested in the paper to check up the statements."

CONSOLIDATED RETURNS UNDER THE EXCESS PROFITS TAX ACT

The following notice, regarding consolidated returns under The Excess Profits Tax Act, appeared in The Canada Gazette of December 25, 1943, over the names of Colin Gibson, Minister of National Revenue, and C. Fraser Elliott, Deputy Minister (Taxation).

The Excess Profits Tax Act provides by Section 10: "Where a taxpayer has elected under subsection three of section thirty-five of the Income War Tax Act to file a consolidated return for the taxation year, such election shall apply to the returns required under this Act."

The Excess Profits Tax Act however is silent on the question of how the standard profits of the parent and the several subsidiary companies forming the consolidation shall be determined.

It is therefore required of the Minister, by Section 75, subsection 2 of the Income War Tax Act, which is incorporated by Section 14 thereof as part of The Excess Profits Tax Act, to "make any regulations deemed necessary for carrying this Act into effect. . . ."

The following regulation is therefore made, namely:

"1. Companies that elect or have elected since 1st January 1940 to file consolidated returns shall have as their standard profits for consolidation purposes the standard profits, whether factual or ascribed, of that bona fide, continuing, operating company which of all forming the consolidation has the highest standard, plus $5,000 added thereto for each subsidiary company forming part of the consolidation, whether such other companies have or have not standard profits greater than $5,000.

"2. If subsidiary companies are added to and become part of an existing consolidation on or after the 1st January 1940 the standard profit of the consolidation shall be increased by $5,000, for each such subsidiary company.

"3. Nothing herein shall be deemed to affect the operation of Section 15 or Section 15A of The Excess Profits Tax Act."

Dated at Ottawa this 11th day of November, 1943.

Personals

Messrs. Peat, Marwick, Mitchell & Company, chartered accountants, announce that James C. Thompson, F.C.A., entered their firm as a partner on 3rd January 1944.

The practice of James C. Thompson & Company will be conducted in the future under the name of Peat, Marwick, Mitchell & Company from their offices throughout Canada.

Harold S. Hanson, chartered accountant, Winnipeg, announces the admission to partnership of Albert H. Fisher, chartered accountant, for the practice of their profession which will be continued under the firm name of Black, Hanson & Company, chartered accountants, Nanton Building, Winnipeg, Manitoba.

An Income Tax Calculation

By G. E. F. Smith
Chartered Accountant
Hamilton, Ontario

At some time it is required to know what a person's salary or wages would be if a certain sum is expected after having made provision for income tax.

Problem

A married man with two dependent children expects, after having made provision for income tax, to get $2,000 per annum. What will be his salary?

Solution

Let x equal amount of salary. Then:

Normal tax is 7% of x		$= \frac{7x}{100}$	
Less allowances for children			— 56.00
Graduated tax is as follows:			
Exemption	660.00		
Tax on	1,000.00		+ 315.00
and 37% on excess, x — 1,660.00		$= \frac{37x}{100}$	— 614.20
less allowances for wife and children			— 310.00
Salary remaining			+2,000.00
Addition gives salary,	x	$= \frac{44x}{100}$	+ 1,334.80
Multiplying by 100, ...	100x	$= 44x$	+133,480.00
and		56x	=133,480.00
and		x	= 2,383.57

The graduated tax was found by inspecting the graduated tax table. It is obvious that the graduated tax is that between 1,000 and 2,000 dollars and is, therefore, 315 plus 37% of (x—1,660) dollars, as shown. The next higher item in the table applies only to salaries lying between 2,660 and 4,160 dollars and it is clear that the total tax could not be as high as 660 dollars which it would have to be if only 2,000 dollars is to remain.

From a study of the solution it is seen that the following formula can be used for similar problems:

Add to the graduated tax before excess, the salary remaining. Subtract therefrom all allowances for dependents plus the percentage on excess (graduated tax) taken on that part of the salary to which excess does not apply.

Multiply the result by 100 and divide the product by 100 less the rate per cent of the normal tax added to the rate per cent of the excess on graduated tax.

It will happen that a test has to be made in order to find which one of two lines in the graduated tax table must be used.

For example, if the amount of the remaining salary required is 5,000 dollars it cannot be determined offhand if the graduated tax is that between 5,000 and 8,000 dollars or that between 8,000 and 13,000 dollars. The test would be made with the latter line because no calculation would have to be made in respect of tax on excess over 8,000 dollars in order to determine which of the two lines must be used. The test gives:

Normal tax—7% on 8,660 dollars	606.20
Graduated tax on 8,000 dollars	3,475.00
	4,081.20
Less allowances for dependents	366.00
	3,715.20
Salary	8,660.00
Salary remaining	4,944.80

It is seen that the salary tested, 8,660 dollars, is not sufficiently high. Both salary and tax must be increased to satisfy the problem. The test does show that the right line of the two in the Table was selected and therefore the graduated tax will be 3,475 plus 55% of (x—8,660) dollars.

Using the formula given above there is obtained:

Graduated Tax before excess		3,475.00
Salary remaining		5,000.00
Allowances for dependents	366.00	8,475.00
Percentage on excess, taken on that part of the salary to which excess does not apply, 55% of 8,660	4,763.00	5,129.00
		3,346.00

	3,346.00 x 100		= 334,600.00
Divided by		100	
Less rate % Normal tax	7		
Less rate %, on excess	55	62	
		38	= 8,805.26

Book Review

"Integral Accounting" by Joseph Serman. Published by Gee and Company (Publishers) Limited, London, England, 1943, hard cover, 92 pp., price 25/-.

The usual practice has been to a definite segregation of the cost accounting away from the general or "normal" accounting system. Many accountants disagree with this practice and will be very interested in reading a practical handbook on a system that has been used for over "40 years" where the accounts are interwoven with the regular general ledger accounts.

The author states his purpose in writing as "that of writing cost accounting generally with the normal accounts".

This book does not enter into any theories relative to cost accounting but describes, in considerable detail, the actual accounting procedure by which cost accountants are developed. A thorough study of such a text by students or members of the profession, not having extensive experience with cost accounts, will prove valuable.

Many books and articles on cost accounts deal at great length with the theoretical side of the problem but few set forth the practical bookkeeping necessary to produce the desired results.

HOLLAND PETTIT, JR.

T. 1 SPECIAL FORMS FOR 1943

The Canada Gazette of January 15th, 1944 contains specimens, in English and French, of the T.1 Special 1943 forms, accompanied by the following minute of a meeting of the Treasury Board approved by the Governor General in Council:

The Board recommend that, in accordance with the provisions of Section 9A, subsection 3 of the Income War Tax Act, as enacted by Section 13 of Chapter 14 of the Statutes of 1943, the attached income tax form, designated as T-1 Special, 1943, the Table of taxes as set forth, and other relevant matters therein contained, be authorized, approved and promulgated as the form to be used, the tax payable, and the maximum refundable portion of the tax, and the information to be given for the 1943 taxation period, at the times and in the manner prescribed, subject to all the provisions of the Income War Tax Act, by individuals having not over $3,000 of income, including therein not over $1,500 of investment income, provided the term "individuals" shall not include, for the purposes hereof, proprietors and partners in any manufacturing, trading or merchandising business, or members of the Canadian Naval, Military or Air Forces.

ADJUSTMENTS TO STANDARD PROFITS UNDER E. P. TAX ACT

The following regulation dated January 13, 1944, appeared in The Canada Gazette of January 22, 1944, over the signatures of Colin Gibson, Minister of National Revenue and C. F. Elliott, Deputy Minister (Taxation):

The Excess Profits Tax Act provides by Section 4, subsection 1, that the Minister in his discretion may adjust the standard profits in the case where any alteration in the Capital Employed since the commencement of the last year or fiscal period of the taxpayer in the standard period has occurred, by adding to or deducting from (accordingly as the capital has been increased or reduced) the standard profits an amount equal to seven and one-half per centum per annum of the amount of the alteration in the Capital Employed provided that in the case of a corporation or joint stock company such adjustment may only be made if the alteration in Capital Employed was accompanied by an equivalent alteration in capital stock.

By Section 75, subsection 2 of the Income War Tax Act, which is incorporated by Section 14 of the Excess Profits Tax Act as part of the said Act, the Minister may, "make any regulations deemed necessary for carrying this Act into effect . . . ." Accordingly the following Regulation is hereby made:

1. Under Section 4, subsection 1, of the Excess Profits Tax Act, the Standard Profits for any taxation year shall be adjusted when there is an alteration in Capital Employed at the beginning of any such taxation year as compared with the Capital Employed at the beginning of the last year or fiscal period in the Standard Period, if there is also an alteration (upwards if the Capital Employed has been altered upwards and downwards if the Capital Employed has been altered downwards) in the capital stock at the beginning of any such taxation year, as compared with the capital stock at the beginning of the last year or fiscal period in the Standard Period.

Any such adjustment to the Standard Profits shall be limited to 7½ per centum per annum of the lesser of either the alteration in the Capital Employed, or the alteration in the capital stock as at the beginning of any such taxation year when compared with the beginning of the last year or fiscal period of the Standard Period.

Capital stock at the beginning of any taxation year shall be increased or decreased by the pro-rated amount of any alterations in capital stock made during the course of the year.

2. "Taxation period" or "taxation year" means any fiscal period ending on or after the 1st January, 1940.

Provincial News

Saskatchewan

The president of The Dominion Association of Chartered Accountants, Mr. H. G. Norman, C.M.G., Montreal, was a visitor in Regina on official business on Monday, January 10th. Mr. Norman is financial adviser to the Commonwealth Air-Training Plan.

In his honour the members of the Regina Chartered Accountants' Club, and the officers and council of the provincial Institute entertained at dinner in the Hotel Saskatchewan, Monday evening. Mr. Clair H. Smith, president of the local Club presided over the gathering.

Mr. Norman, who was introduced by Mr. T. H. Moffet, president of the provincial Institute, reported to the members on the activities of the various committees of the Dominion Association during the past year.

Among those present were Messrs. G. C. Rooke and W. E. Hodge, both past-presidents of The Dominion Association of Chartered Accountants.

Those who attended from other cities were, C. P. DeRoche, G. G. Patrick, and J. H. Thompson all of Saskatoon; W. E. Hodge and T. R. Wilder, both of Moose Jaw; and Wing-Commander G. A. Cruikshank of Ottawa.

TAX COLLECTIONS INCREASED

According to announcement by the Department of National Revenue, during the nine months ended Dec. 31, 1943, income, excise and customs revenues amounted to $1,868,181,750, against $1,557,921,441 in the corresponding period of 1942, an increase of $310,260,309.

Income tax collections alone amounted to $1,188,442,459, an increase of $180,250,557. Customs and excise collections were $130,009,753 higher at $679,739,291.

All 19 income tax districts showed increases for the month period. Montreal district held first place with revenue of $331,401,969, an increase of $27,856,677. Toronto district held second place with $289,552,055, an increase of $13,502,742.

Obituary

The Late Henry Webster Barber

The Institute of Chartered Accountants of Ontario regrets to announce the death of Henry Webster Barber, of Messrs. Henry Barber, Mapp & Mapp, at Meadowvale, Ontario, on January 14th, 1944, in his 85th year.

The late Mr. Barber was admitted a member of the Institute on February 21st, 1889, and was one of the oldest members of the Institute. He took an active part in Institute affairs in the early days, and served on council in 1891 and 1892 and from 1894-1896. He was granted a fellowship in 1895, and in 1933 was voted a life member of the Institute.

Until a few years ago when he retired from the active practice of his profession and went to live at Meadowvale, Mr. Barber held an interest in Institute affairs and was often seen at the various functions.

To his widow and son the Institute offers sincere sympathy.

"PETTY CASH" AT LAST IDENTIFIED

Through "The Journal of Accountancy" we learn that "petty cash", who so often has eluded pursuit, has been brought to earth, and the cause of his downfall was, naturally, a woman. The scene was enacted in Virginia, and is described as follows by the Norfolk Virginian-Pilot:

> An initial clue in the robbery last Friday night of the USO Club, Colored, on Smith Street, came yesterday under very unusual circumstances.
>
> It appears that a check made out to "petty cash" was among the loot and, as is customary in such cases, a "stop payment" order was circulated to the several banks.
>
> When the purloined check was tendered to a teller at a Church Street bank by a Negro woman, naturally he was prepared not to honor it, but just to delay for time so that he could call police, he called attention to the fact that the check bore no endorsement.
>
> The woman accommodatingly stepped to a customer's counter, made the endorsement, and quickly returned to the cage. She again presented the check, which bore the endorsement, "Thelma Cash."
>
> "You're Thelma Cash?" he asked.
>
> "Yes, I'm Thelma Cash," was her response. "I'm the wife of Petty Cash."
>
> By that time, the woman's suspicions were aroused, and leaving the check behind, she made a quick exit. With her, went the only clue thus far to the robbery, except, perhaps, a rather good description of Thelma Cash which was furnished by the teller.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

It is inevitable that in a time of national crisis the activities of the federal government should overshadow in the popular mind those of provincial and still more those of municipal governments. But it would be an evil day if ever the administration of public affairs became so centralized that the municipalities were left with a negligible part or with no part in that administration. Last summer Mr. Carl H. Chatters, the executive director of the Municipal Finance Officers Association of the United States and Canada, made a plea in an address before the National Security Traders Association for action now by all municipalities to ensure that when the crisis ended they would be in sound financial condition, fit and ready to play a big part in post-war reconstruction and amelioration. "The war may be the opportunity to make highly desirable changes that could not be obtained in normal times or it may be used as the excuse for 'sloppy' work. All of us with an interest in municipal finance should use the war as a means of getting better laws, eliminating harmful practices, cutting out dead wood and generally putting our municipal house in order. . . . What municipalities do now determines what they will be able to do or will be compelled to do in the post-war era. Municipalities which weaken their financial structures now must inevitably spend the post-war period 'burying dead horses' and trying to get out of the hole . . . . A municipality which makes no conscious plans, but lets its finances drift into difficulty, has just as certainly made its plans for a future that is dark. But a municipality that takes constructive steps now will be in a position to carry out whatever plans the post-war era requires."

As accountants, if we believe that there is some connection between political liberty and decentralization of government, we can further the cause by equipping ourselves with a wide and accurate knowledge of municipal accounting and finance and by participating with that equipment

in the conduct of the affairs of our local community, whether it be city, village, county or township.

* * *

There is a steadily widening appreciation of the great importance of human relationships in modern industrial management and of Sidney Webb's description of management as the handling of human nature in conjunction with machinery and materials with a view to its perfect co-operation in an industrial enterprise. The whole thing is well summed up in the sentence "Works are as full of human feelings as they are of machinery", and we may regard it as a healthy sign that at least one of our Canadian universities established six years ago a section of industrial relations and that others have recently founded, or are planning to found, similar schools where research can be conducted and whence sorely needed information with respect to personnel administration can be disseminated.

* * *

Labour News, a publication of the Workers' Educational Association, in its issue of October last contained an article which began: "With more and more companies putting out financial reports with one eye on their employees, union officers need to be on the alert for seemingly impressive but actually irrelevant and meaningless comparisons". The article cited, as an example of such comparisons, an analysis of the annual report of Canada Packers Ltd. which had appeared in *The Financial Post* and which read in part, "during four years of war the profit margin on Canada Packers' sales volume has shown a steady decrease, from 1.6% for the year ended March 1939 to .95% for 1943". The article proceeded to point out that this decline in the profit margin on sales value had not resulted in any reduction of total earnings (because of the increased volume of sales). It concluded with a comparison of its own which, in view of the opening sentence of the article, merits quotation in full: "This 'profit margin on sales value' does however tell us one important thing when we note that 'earnings' have been steadily increasing—evidently if the company had been handling as large quantities of meat in 1939 as it is now, the stockholders would have been able to get the same total profits from about 80 cents profit on each $100 sale instead of the $1.60 they were getting. In fact even this figure is much too high—there have been

large increases in taxes, in the prices of the meat to the farmers, and in payrolls since 1939 which would not have had to be taken into consideration in calculating the profit on larger sales volume then." A reader might be forgiven for asking himself whether *this* comparison is entirely relevant and meaningful.

* * *

This same article contained another comparison of its own for Canada Packers Ltd.: "Last year's earnings after taxes were $24 on each $100 of capital employed." The ratio of earnings to capital employed is certainly significant and relevant, though for many purposes less so than the ratio of earnings to total assets. But the more significant a ratio may be, the more important it is that it be calculated accurately. The published statements show: Net profit $1,611,418, common share capital $1,438,284, earned surplus $10,384,853, appraisal surplus $5,617,483. The nearest approach we are able to make to a 24 per cent ratio from these figures is by combining share capital with appraisal surplus. If capital employed is to be construed conservatively it will be taken as the sum of the common share capital and the earned surplus (to the exclusion of appraisal surplus) and the ratio becomes 13.7 per cent. If the appraisal surplus is included in the measure of capital employed the ratio becomes 9.2 per cent.

* * *

CORRESPONDENCE

Edmonton, Alberta.

Editor, The Students' Department.
Dear Sir:

In the Students' Department of the December 1943 issue of *The Canadian Chartered Accountant* there is a brief discussion of the problem of speed in examination problems involving the preparation of operating statements and a balance sheet.

While getting ready for the primary examination held recently, I worked out several such problems. In the beginning, I used the method outlined by you, completing one statement, then passing on to the next and drawing up a balance sheet last. Later, how exactly I do not know, I developed what I now call the "simultaneous" method. The attached very rough working sheet for the solution of question 1, paper C, of the recent primary examination will

enable you to follow the steps taken. In the examination I worked along the exact lines to be described. Please note that the "simultaneous" method requires that the mind have a very clear picture of the approximate position that any given item will occupy on the working sheet.

Very well! We are in the examination room, have glanced quite carefully through paper C, and have decided to tackle question 1. We give the trial balance a rapid, but searching, scrutiny. Points noted, mentally, are that separate buildings exist for factory and office, that $1,800 paid for insurance applies on stock. (a general and administration expense), and that other insurance is lumped with "maintenance, repairs and insurance".

We now turn our attention to the adjustments. You will see these scribbled down, very roughly but in true double-entry form, in the top left-hand corner of the working sheet. Not all the amounts are filled in immediately. In the case of the depreciation adjustments merely the percentage figures are noted.

We go back to the trial balance and take it item by item. "Accounts payable, $41,650", heads the list—a balance sheet item—with an adjustment of $1,000, (we remember that vividly—just finished jotting it down, in fact). We start a balance sheet, as you will observe, and score off the adjustments from our list.

Next comes "accounts receivable $52,500"—and more adjustments. You will see them made and a figure of $53,000 resulting. What reserve for bad debts do we need? Oh, yes! 10% or $5,300. When we come to the trial balance figure of reserve for bad debts we will be able to figure the estimated loss by bad debts. We have a blank space in our "adjustment" list for it. We won't miss it.

Next is "advertising, $7,000".—trading section 2. We figure the position on the sheet and jot it down. Then we have "bank loan", "bills payable", "bonds payable"—balance sheet items. Down they go. "bond interest paid, $2,500"—and an adjustment for interest accrued—a profit and loss item. "building, factory, $140,000", "buildings, office, $20,000"—more for the balance sheet. How about depreciation? 2½% in each case, $3,500 and $500 respectively—fill in the spaces in the "adjustment" list.

And so on, each item on the trial balance being disposed of in order, followed by the adjustments, the exact

figures for any missing items being now all obtained and all the blank spaces filled in. (We look them over to make sure.)

At last we have them down on our "working sheet". Now for the adding and subtracting! Horror! Our balance sheet is out $1,000.

Easy, now, easy! You've made some fool error adding or subtracting. Relax and look things over. Only thirty minutes have gone. You still have two hundred and ten. Be nonchalant. Manufacturing account—seems all right. Trading section 1—nothing wrong there. Section 2—not there either. Profit and loss—can't change it. Accounts receivable—$53,000 less $5,300—(say, you dope, when will you learn simple arithmetic?)—$47,700 not $48,700. Hurray, we're balanced! Now to copy it out so a person can read it!

I admit the one big disadvantage of this method—it necessitates rewriting. But, consider the advantages.

A person arrives at a solution in the shortest possible time, thirty or forty minutes is my experience. And, most soothing to the nerves it is to know that a fair slice of those 35 marks is in the bag.

Secondly, a really neat job can be done of the re-writing. One can afford to spend half an hour over it. The rough draft of each statement gives a wonderful idea of the space to be allowed. You will notice that no sub-total for fixed assets is shown on the working sheet. There was no room for it, because of bad spacing. That can easily be corrected on the final copy.

Thirdly, there is no need to "comb" the trial balance time after time for each separate statement. Once through it suffices. There *is* a saving of time there.

Fourthly, as each item goes down in the final draft, the mind is active, reviewing the working out of the whole problem, quite familiar now with all the figures and adjustments.

Lastly, if I were so hard pressed for time as to be unable to complete the job of re-writing (others would possibly be similarly situated, too) I think I would draw up a neat balance sheet, to show I had arrived at a solution. For the other statements, I would throw myself on the mercy of the examiner, submitting my working sheet and

trusting to goodness he would be able to see how I got my answer and give me a few marks for it—maybe!

People differ in temperament. For myself, I like to take hold of an item, make a decision with regard to it and dispose of it. I find it irritating to have to scrutinize the trial balance repeatedly, as is necessary when each statement is prepared and completed separately. Further, it suits me to keep my hands actively writing while my mind—such as it is—is occupied with a problem of this type where much is to be written. If both mind and hands are working, both seem to do better work.

I trust that you will receive comments from other students regarding this topic and shall be very pleased to hear of alternative methods which some must certainly have devised for themselves.

Yours very truly,
(Signed) JOSEPH FALLER.

(We are sorry that it is not practicable to reproduce the working sheet by which Mr. Faller illustrated his letter, but we think most of our readers will be able to envisage it anyhow. Letters like this make a real contribution to our department and we hope we may receive more on this same important topic.—EDITOR)

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

FINAL EXAMINATION, DECEMBER 1942

Accounting IV, Question 2 (20 marks)

Describe briefly the essential characteristics of the following methods of valuing inventories of merchandise:

(a) Retail
(b) Base stock
(c) Last-in first-out
(d) Standard cost.

In each case, state one situation, business or industry where it might be used to advantage and be considered good accounting practice.

SOLUTION

(a) Retail. Under this method a record of opening inventory and purchases is kept to show both cost and retail selling prices.

Adjustments are made for subsequent increases or decreases in selling prices. As both cost and selling prices are shown on the account, the average ratio of cost to selling price can readily be obtained.

At any time, the total of sales may be deducted from the total selling price of opening inventory and purchases, and the resultant balance represents inventory which should be on hand at selling price. This can be compared with the physical inventory taken at selling price.

The inventory at selling price is reduced to approximate cost by the application of the ratio of cost to retail.

This method is used by departmental and other retail stores, because it provides an effective and practical means of control of merchandise, and because the volume of articles handled makes it impractical to keep a detailed record of the cost of each article.

Illustration (From Finney, *Principles of Accounting—Intermediate*, p. 201)

Item	*Cost*	*Retail*
Opening inventory	$ 53,333.00	$ 80,000.00
Purchases for the period	400,000.00	500,000.00
Mark-ups	—	25,000.00
Totals (cost ratio: 74.9311%)	$453,333.00	605,000.00
Sales		385,000.00
Inventory at retail		$220,000.00

Inventory valuation by the retail method:
74.9311% of $220,000.00 = $164,848.00

Comment

"The retail inventory method is based on the assumption that an average cost ratio can be applied to the selling price of the inventory. Since averages are often deceptive, however, all factors which might tend to make the assumption untrue should be recognized and properly dealt with. Some of these factors are . . . ."

(a) "The retail inventory method assumes that high-cost-ratio goods and low-cost-ratio goods will be found in the same proportions in the final inventory as in the total of goods offered for sale." Hence "it is desirable to keep departmental records, in order that a separate computation can be made for the inventory of each department".

(b) "Consideration must also be given to the fact that special sales of merchandise carrying low rates of mark-up may distort the average."

(c) "A year is too long a period to embrace in the inventory computation unless approximately the same rate of mark-on prevails throughout the year."—(Finney, *op. cit.* pp. 198-201.)

"It is generally considered to be the most scientific and satisfactory method of valuing inventories for retail enterprises although during the past two years several of the larger department stores have superimposed last-in first-out on the retail method."—(Foulke, *Our Critical Wealth in Industries* (Dun & Bradstreet, 1942), p. 34.)

(b) Base stock. Normal inventory quantities as established, are valued from year to year at a fixed price, supposed to be a "normal" or mean price. Quantities in excess of the base stock amounts are valued at the lower of cost or market.

The method is used by industries which use one or more basic commodities and necessarily carry large stocks, due to long conversion periods required or other causes, e.g., smelters and agricultural implement manufacturers. It is used to avoid showing large profits or

losses on inventories in a rising or falling market, the argument being that the investment in the base quantity is practically fixed and should not fluctuate in value with market prices.

Illustration (From Foulke, *op. cit.* pp. 29 and 33.)

Suppose a business concern enters its fiscal year with 1,000,000 pounds of copper. Suppose the last purchases made during the year (in date order) were 400,000 pounds at eight cents per pound, 500,000 pounds at nine cents per pound, and 200,000 pounds at ten cents per pound at which price of ten cents per pound the market closes at the end of the fiscal year. Now suppose an inventory of 1,100,000 pounds of copper is on hand as the year closes.

If 500,000 pounds of copper should be the base stock, then the inventory of the 1,100,000 pounds would be valued (1) 500,000 pounds at a base price, say of four cents a pound, or $20,000, and (2) 600,000 pounds on the first-in first-out basis, 400,000 pounds at nine cents per pound and 200,000 pounds at ten cents per pound or $56,000, giving an inventory valuation of $76,000.

Comment

"The underlying theory is that the reserve stock of goods represents a permanent investment of capital analogous to the commitments in plant assets, and accordingly should be priced on the basis of the cost of acquiring the original supply (or on some other basis if this is not low enough to satisfy the conservatism of the management)....

"On the whole the policy is not to be recommended. The normal or base volume of inventory is no more a fixed asset than the average bank balance, and to hold otherwise would simply mean an obscuring of the current—fixed classification . . . ."—(Paton, *op. cit.* p. 159.)

"The base stock method of inventory valuation has been used in Scotland, Wales, England and Holland for more than half a century, although it is not generally accepted even in those countries. The American Smelting and Refining Company appears to have been the first large corporation in the United States to have adopted the base stock method, having made the innovation in 1903. The National Lead Company adopted this procedure in 1913, the American Can Company in 1917, and Endicott-Johnson Corporation in 1936. The United States Treasury Department has consistently refused to recognize the use of base stock accounting in corporate income tax returns."—(Foulke, *op. cit.* p. 33.)

(c) Last-in first-out. This method which is an alternative to the base stock method assumes that the goods last purchased are the first used, or, in other words, that goods are acquired or fabricated for stock until the amount of the inventory has been accumulated and that thereafter all costs incurred pass directly into operating charges. Its use ensures that current costs are applied to current sales. It is appropriate in the same circumstances as the base stock method.

Illustration (From Paton, *op. cit.* p. 143.)

The M. Co. during its first month of operation buys a particular class of materials in five lots as follows:

Date	Quantity	Price	Amount
Jan. 5............	1,000	$3.0000	$ 3,000.00
12............	4,000	2.9000	11,600.00
20............	2,000	2.9000	5,800.00
25............	1,500	3.0000	4,500.00
30............	3,000	3.1425	9,427.50

The physical inventory at the end of January is 5,000 units.

With an inventory of 5,000 units at the end of the month out of total acquisitions of 11,500 units, the amount drawn or disposed of is 6,500 units. This amount just absorbs the last three lots acquired.

The cost of goods used in January, then, is determined as follows:

Date	Quantity	Price	Amount
Jan. 30............	3,000	$3.1425	$ 9,427.50
25............	1,500	3.0000	4,500.00
20............	2,000	2.9000	5,800.00
	6,500		$19,727.50

The cost of goods remaining in stock consists of the remaining lots, in this case the first two acquired, as shown by the following:

Date	Quantity	Price	Amount
Jan. 12............	4,000	$2.9000	$11,600.00
5............	1,000	3.0000	3,000.00
	5,000		$14,600.00

In the following period the opening inventory would represent the oldest stock and hence be the first component of the next inventory taken. Assuming no change in the physical amount of stock on hand at succeeding inventory dates it is noticeable that the effect of the method is to peg the inventory permanently at precisely the amount of the cost of the original accumulation.

Comment

"The use of last-in first-out as compared with first-in first-out procedure undoubtedly tends to reduce the fluctuations from period to period in reported net income, and the advocates of the former method make much of this fact . . . . The question then arises, is this stabilizing desirable? In answering this query a clear distinction must be drawn between the stabilization of the actual volume of business and of the actual income, and a policy of statistical smoothing or averaging. No doubt there is much to be said for any promising program that aims to minimise business fluctuations. It should be equally evident that any plan designed to alter the appearance of business affairs without effecting any change in the objective circumstances is open to serious question."—(Paton, *op. cit.* pp. 146-147.)

"For the average manufacturing or processing concern 'last-in first-out' method of inventory valuation comes nearer to revealing to management, to stockholders, and to creditors, the true condition of the business, and the real profits or losses than any other accounting formula which has yet been devised. . . . This system of inventory valuation was first recognized by statutory provision of the [U.S.A.] Revenue Act of 1939. The fact that many important corporations had adopted this interpretation of cost before it was permitted for tax purposes indicates that, in some cases, benefits other than those arising from income tax reasons were responsible for its adoption."—(Foulke, *op. cit.* p. 36.)

(d) Standard Cost. Under this method goods fabricated are valued at the standard cost which is based on the capacity or volume of production for which the plant was designed.

This method is used by many concerns in which the standard cost method is practicable, i.e., where the same article is produced in large quantities and frequently, such as furniture or automobile manufactures.

[The illustrations and comments above are not within the scope of the question or of an appropriate answer to the question. They are given here to enhance the value and interest of the treatment.—Editor]